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October 15, 2009

Court Interprets "Retiree Benefits" Under Bankruptcy Law Without Reference to ERISA

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The Bankruptcy Court for the District of Delaware has issued a decision concluding that company-paid medical coverage offered as part of an employee severance package is a "retiree benefit" that cannot be unilaterally modified by the company in bankruptcy, except as provided under Section 1114 of the Bankruptcy Code. The court ruled that other payments under the package—salary continuation and car allowance payments—are not "retiree benefits" under Section 1114. The court based its decision on the medical coverage issue primarily on the company's own description of the severance offer as "an early retirement package" and declined to apply the definition of "retiree benefits" under ERISA.[1]

Background

Under section 1114 of the Bankruptcy Code, a company in Chapter 11 bankruptcy is required to pay, throughout the reorganization, retiree medical benefits under a "plan, fund, or program" at the same levels it paid prior to bankruptcy, until or unless a modification is agreed to by the parties or ordered by the court.[2] In the absence of agreement between the company and the retirees (ordinarily acting through an authorized representative such as a union or a committee), the court may approve a modification requested by the company only if the company previously made a proposal to the retirees that meets certain conditions, and the retirees rejected such proposal.[3]

[1] *In re Arclin US Holding, Inc.*, No. 09-12628 (Bankr. D. Del. Oct. 9, 2009). A copy of the court's memorandum decision is available at *http://www.kccllc.net/documents/0912628/091262809100900000000004.pdf*.

[2] *See* 11 U.S.C. §1114(e)(1); *see also In re New York Trap Rock Corp.*, 126 B.R. 19, 21-22 (Bankr. S.D.N.Y. 1991) (setting forth history and purpose of section 1114).

[3] The company's proposal to the retirees must (a) be based on the most complete and reliable information available, (b) provide for modifications that are necessary to permit the company to reorganize, (c) assure fair and equitable treatment of all

In the *Arclin* case, the issue was whether the payments offered to an employee under a severance package constituted "retiree benefits," as defined in section 1114 of the Bankruptcy Code, and specifically whether the payments were for medical benefits "under any plan, fund, or program." The company argued that payments promised to the employee under the severance package were not "retiree benefits" because (a) the severance package did not fall within the ERISA definition of "plan, fund, or program" and (b) the payments were offered in connection with the employee's termination, not retirement.

The Severance Package

In *Arclin*, several months before filing for bankruptcy protection the company implemented a company-wide reduction-in-force. Steve Phillips, an employee at the company, was offered a severance package that consisted of two years of salary and car allowance paid at regular intervals, plus 29 months of company-paid health insurance premiums. The offer was made to Phillips by a letter in which the company described the offer as "an early retirement package" in recognition of his years of service.

On the petition date several months later, the company stopped paying Phillips his salary, car allowance and health premiums. Phillips wrote a letter to the bankruptcy court stating that the company's decision to cease making payments had caused extreme hardship to him and his family and asking the court to order the company to reinstate and pay the amounts due under the severance package.[4] The company responded arguing that the severance package was an ordinary non-executory contract giving Mr. Phillips a damages claim for the unpaid amounts, but that there was no legal basis to reinstate making payments under the package.

The Bankruptcy Court's Ruling

The Bankruptcy Court initially agreed with the company and denied Mr. Phillips's request to reinstate the payments. However, before issuing a final ruling, the court directed the parties specifically to brief the issue of whether any part of the payments due under the severance package was subject to Bankruptcy Code section 1114. It was on that issue that the bankruptcy court issued its final ruling.

The court easily concluded that the company's obligation to make payments to Mr. Phillips for salary and car allowance were not "retiree benefits" within the meaning of the Bankruptcy Code definition because they were not payments for medical benefits.[5] That left only the question of the 29 months of health premiums to consider.

The company argued that the payments for health premiums should not qualify as "retiree benefits" because they were not made pursuant to a "plan, fund or program" as that phrase is used in the Employee Retirement Income Security Act of 1974 ("ERISA") and that the court should apply the ERISA definition to the company's obligations under the severance package. The company further noted that while the terms "plan, fund or program" are not defined in the Bankruptcy Code, other bankruptcy courts have used ERISA cases and terminology to interpret the terms in bankruptcy cases. The company argued that under the ERISA definition, the payments to Mr. Phillips would not meet the definition of an ERISA plan. The com-

the company's creditors and (d) provide the retirees with relevant information necessary to evaluate the proposal. 11 U.S.C. §1114(f).

[4] Apparently, Mr. Phillips did not have counsel in connection with the *Arclin* bankruptcy case. The bankruptcy court treated Mr. Phillips's letter as a Motion for Reinstatement of Severance Pay and Medical Benefits and set a hearing date giving the company an opportunity to file a pleading in response to the motion.

[5] *See* Opinion at 4-5; *see also In re Exide Techs.*, 378 B.R. 762, 768 (Bankr. D. Del. 2007).

pany also argued that the payment obligations were incurred in connection with Mr. Phillips's termination, not his retirement.

The court conceded that prior case law has looked to ERISA to define "retiree benefits" under the Bankruptcy Code but also noted recent Supreme Court precedent holding that it is not always appropriate to do so.[6] In particular, the bankruptcy court concluded that "the definition of 'retiree benefits' should not be based 'on a definition borrowed from a statute designed without bankruptcy in mind,' but on the 'essential character' of the Premiums." The company asserted that the essential character of the premium payments, like the other payments, was for severance benefits, not retirement benefits. The court noted, however, that in addition to the company's own characterization of the severance package as "an early retirement package," the "essential character" of the payments for health premiums fell within the plain meaning of "retiree benefits" in Bankruptcy Code section 1114. The court therefore ordered the company to reimburse Phillips for payments he personally made for medical benefits otherwise covered by the severance package, and to pay all premiums going forward, unless and until any termination or modification of the retiree benefits is approved by the court.

Lessons from the *Arclin* Decision

A company contemplating a reduction in force or planning retirement benefits should be mindful of how it publicly characterizes any severance or early retirement package that includes payments for health benefits. The *Arclin* court relied heavily on the company's own description of payments under its severance plan in determining that they were "retiree benefits." Moreover, while companies typically focus (for good reason) on ERISA and employment law issues when designing reduction-in-force incentives, the analysis cannot stop there if a bankruptcy filing is foreseeable. Bankruptcy counsel should be consulted to determine the impact that the company's policies will have on the costs and administration of a company's bankruptcy estate post-petition.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the attorneys below.

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[6] The *Arclin* court cited *Howard Delivery Service, Inc. v. Zurich American Insurance Co.*, 547 U.S. 651 (2006) for the proposition that it is not always appropriate to use ERISA "to fill in blanks in a Bankruptcy Code provision." Opinion at 6.